

Message Text

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ACTION EUR-12

INFO OCT-01 EA-09 NEA-10 IO-11 ISO-00 AID-05 CIAE-00 EB-07

FRB-01 INR-07 NSAE-00 USIA-15 TRSE-00 XMB-04 OPIC-06

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STR-04 CEA-01 AGR-10 FEAE-00 INT-05 /138 W

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FM AMEMBASSY LONDON

TO SECSTATE WASHDC 7982

INFO AMEMBASSY BERN

AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY COPENHAGEN

AMEMBASSY DUBLIN

AMEMBASSY LUXEMBOURG

AMEMBASSY NEW DELHI

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AMCONSUL BELFAST

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UNCLAS SECTION 01 OF 03 LONDON 00440

DEPARTMENT PASS TREASURY AND FRB

E.O. 11652: N/A

TAGS: ECON, UK

SUBJECT: ECONOMIC DEVELOPMENTS - WEEK ENDING JAN. 9,1976

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BEGIN SUMMARY: WITH THE ECONOMY IN THE PROCESS OF

CHANGING DIRECTION THERE ARE A VARIETY OF CONTRADICTIONARY STRAWS IN THE WIND. INDUSTRY PLANS TO REDUCE INVESTMENT IN 1976 WHILE THE QUEUE OF COMPANIES ANXIOUS TO FLOAT EQUITY ISSUES STRETCHES THROUGH MARCH. BUSINESS CONFIDENCE IS RISING BUT THE OUTLOOK FOR NEW ORDERS AND INCREASED HIRING SEEMS UNFAVORABLE. POST CHRISTMAS SALE SHOPPING HAS BROKEN ALL RECORDS BUT THE OVERALL VOLUME OF RETAIL SALES IS NOT EXPECTED TO SHOW APPRECIABLE GAINS. THE GOVERNMENT CONTINUES TO STRESS ITS INTENTION TO HOLD THE LINE ON ALL FORMS OF PUBLIC SPENDING. SERIOUS EFFORTS ARE ALSO BEGINNING ON THE FORMULATION OF THE SECOND PHASE OF THE ANTI-INFLATION PROGRAM.

1. CHANCELLOR STRESSES ANTI-INFLATION PROGRAM. IN A FRANK TELEVISION INTERVIEW ON JANUARY 4, THE CHANCELLOR TOOK A REALISTIC APPROACH TO THE PROBLEMS LIKELY TO CONFRONT THE ECONOMY DURING 1976. REDUCING THE RATE OF INFLATION REMAINS THE PRINCIPAL PRIORITY OF GOVERNMENT POLICY. MR. HEALEY SAID THAT UNTIL THIS WAS ACHIEVED HIS HANDS WERE TIED WITH REGARD TO A MORE GENERAL REFLATION. SUCH A STEP AT THIS POINT WOULD RESULT IN A CURRENT ACCOUNT DEFICIT WHICH COULD NOT BE FINANCED AND COULD FORCE HIM TO ADOPT MEASURES WHICH WOULD RESULT IN A 10 TO 20 PERCENT CUT IN LIVING STANDARDS. HE LOOKED FORWARD TO A SECOND PHASE OF THE CURRENT INCOMES POLICY WHICH WOULD MOVE THE ECONOMY TOWARD A SITUATION WHERE WAGE INCREASES WOULD BE LIMITED TO THE GAIN IN PRODUCTIVITY. POLITICAL REALITIES, HOWEVER, WOULD SLOW PROGRESS TOWARD THIS GOAL. THEREFORE THE INCOMES POLICY WHICH FOLLOWED THE SIX POUND PROGRAM COULD NOT BE BASED ON THE 2-3 POUND PER WEEK INCREASE JUSTIFIED BY PRODUCTIVITY GAINS BUT WOULD HAVE TO BE SOMEWHAT GREATER. MOREOVER, IT WOULD HAVE TO BE FLEXIBLE ENOUGH TO PERMIT THE RESTORATION OF WAGE DIFFERENTIALS ERODED BY THE PRESENT FLAT RATE INCREASE. HE EXPRESSED HIS PERSONAL VIEW THAT MIDDLE INCOME EARNERS (4,000 TO 8,000 POUNDS A YEAR) HAD BEEN HARD HIT BY INFLATION AND RISING TAXES. THEREFORE, HE WOULD LIKE TO TRY TO REDUCE THE INCOME TAX BITE ON THIS GROUP, BUT THE PRICE OF SUCH RELIEF MIGHT BE HIGHER TAXES ON UNEARNED INCOME.

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2. EQUITY MARKETS BUOYANT. THE CONTINUING RISE IN LONDON EQUITY PRICES HAS BROUGHT COMPANIES SEEKING TO SELL STOCK TO THE MARKET ON A LARGE SCALE. THERE ARE INDICATIONS THAT AS MUCH AS 350 MILLION POUNDS OF EQUITY CAPITAL MAY BE RAISED IN THE FIRST QUARTER IF EQUITY PRICES CONTINUE FIRM. IN 1975 A RECORD 1.2 BILLION POUNDS OF NEW EQUITIES WERE SOLD, FOLLOWING A YEAR IN WHICH THE

STOCK MARKET WAS VIRTUALLY MORIBUND. WHILE IT IS TRUE THAT MUCH OF THE FUNDS RAISED IN 1975 WERE USED TO IMPROVE CORPORATE BALANCE SHEETS, IT IS LIKELY THAT A CONSIDERABLE PROPORTION OF THE CAPITAL NOW BEING RAISED WILL FIND ITS WAY INTO NEW INVESTMENT LATER IN THE YEAR.

3. BUSINESS CONFIDENCE GROWING. THE LATEST FINANCIAL TIMES SUMMARY OF BUSINESS OPINION SHOWS THAT THE EROSION IN CONFIDENCE WHICH FOLLOWED THE OIL EMBARGO AND WAS INTENSIFIED BY THE CURRENT RECESSION HAS BEEN HALTED. THE IMPROVEMENT IN BUSINESS CONFIDENCE DERIVES FROM THE GROWING VIEW THAT THE RECESSION HAS BOTTOMED OUT, INFLATION IS SLOWING AND THAT IMPROVING DEMAND WILL GENERATE AN UPTURN IN UK EXPORTS. MORE SPECIFICALLY, THE SURVEY INDICATES THAT:

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-- THOSE EXPECTING EXPORT EARNINGS TO HOLD STEADY
OR RISE OUTNUMBER THOSE EXPECTING THEM TO DROP BY
5 TO 4
-- THOSE MORE OPTIMISTIC OR NEUTRAL ABOUT PROSPECTS
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TODAY OVER THOSE OF FOUR MONTHS EARLIER OUTNUMBER
THEIR PESSIMISTIC COUNTERPARTS BY 4 TO 1
-- THOSE EXPECTING HIGHER OR STEADY EXPORTS NEXT
YEAR OUTNUMBER THOSE EXPECTING LOWER EXPORTS BY
13 TO 1.
HOWEVER, WITH REGARD TO OUTPUT AND NEW ORDERS THE TREND
IS LESS POSITIVE. 55 PERCENT REPORT A DECLINING TREND
IN NEW ORDERS WHILE NEARLY 70 PERCENT EXPECT LITTLE OR
NO INCREASE IN SALES. IN ADDITION THE SURVEY POINTS TO
LITTLE OR NO NET ADDITIONS TO INVENTORIES OF EITHER RAW
MATERIALS OR FINISHED GOODS. FULLY 91 PERCENT OF ALL RE-
SPONDENTS POINT TO LOW LEVELS OF DOMESTIC DEMAND AS THE
PRINCIPAL FACTOR AFFECTING PRODUCTION. THE CONSENSUS OF
OPINION IS THAT WAGES WILL RISE BY 10 TO 20 PERCENT IN
1976 WITH UNIT COSTS RISING BY A SIMILAR PERCENTAGE.
PROFITS ARE EXPECTED TO IMPROVE BY 21 PERCENT OF THOSE
RESPONDING, TO HOLD STEADY BY 30 PERCENT, AND TO DECLINE
BY 42 PERCENT. WITH REGARD TO EMPLOYMENT, 60 PERCENT ARE
SATISFIED WITH CURRENT LEVELS OF MANPOWER: 31 PERCENT EX-
PECT TO MAKE FURTHER LAYOFFS WHILE JUST 9 PERCENT FORE-
SEE ANY NEW HIRING. INVESTMENT PLANS ARE STILL DIVERGENT
WITH 27 PERCENT INTENDING TO INCREASE THE VOLUME OF IN-
VESTMENT, 10 PERCENT TO INCREASE VALUE BUT NOT VOLUME, 19
PERCENT TO KEEP INVESTMENT AT CURRENT LEVELS AND 44 PER-
CENT TO CUT INVESTMENT.

4. NATIONALIZED INDUSTRY EUROBOND ISSUE. FOR THE FIRST
TIME IN TWO YEARS A UK NATIONALIZED INDUSTRY IS PLANNING
TO RAISE FUNDS THROUGH THE EUROMARKETS. THE BRITISH GAS
CORPORATION PLANS TO FLOAT A \$40 MILLION EUROBOND ISSUE
WITH A REPORTED 5-YEAR MATURITY AT 9 PERCENT. THE ISSUE

IS VIEWED AS A TRIAL OPERATION AND IF SUCCESSFUL, COULD OPEN THE WAY FOR ADDITIONAL EUROMARKET BORROWINGS BY OTHER NATIONALIZED INDUSTRIES. PRESS REPORTS INDICATE THAT THE DECISION TO LAUNCH THE ISSUE AT THIS TIME RESULTED FROM AN ASSUMPTION THAT MARKET ATTITUDES TOWARDS BRITAIN HAVE CHANGED SINCE THE GOVERNMENT TOOK A HARDER LINE ON ECONOMIC POLICY AND THAT THE IMF DRAWING WILL TEND TO STRENGTHEN THE UK'S CREDIT POSITION.

5. MANUFACTURING INVESTMENT IN 1976. THE LATEST QUARTER UNCLASSIFIED

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LY SURVEY OF INVESTMENT INTENTIONS PUBLISHED BY THE DEPARTMENT OF INDUSTRY POINTS TO A FURTHER DECLINE OF 5 TO 8 PERCENT IN MANUFACTURING INVESTMENT IN 1976. INVESTMENT IN DISTRIBUTION AND SERVICES IS FORECAST TO DECLINE BY 2-5 PERCENT OVER THE SAME PERIOD. FOR 1976, PRELIMINARY INDICATIONS ARE THAT MANUFACTURING INVESTMENT DROPPED BY 13 PERCENT WHILE THAT IN DISTRIBUTION AND SERVICES WAS 12 PERCENT LOWER. THE SURVEY RESULTS, WHILE TENTATIVE AT BEST, SEEM TO INDICATE THAT MANUFACTURING INVESTMENT MAY RESUME AN UPWARD TREND DURING THE SECOND OR THIRD QUARTER. GREATER THAN AVERAGE FALLS IN INVESTMENT ARE EXPECTED IN METAL MANUFACTURING, COAL, PETROLEUM AND PERHAPS CHEMICALS. FOR INDUSTRY AS A WHOLE EXPENDITURE ON NEW BUILDING WORK IS EXPECTED TO DROP MORE THAN ON PLANT AND VEHICLES.

6. PUBLIC /HOUSING FUNDS REDUCED. AFTER DECISIONS IN AUGUST AND NOVEMBER TO HOLD LOCAL GOVERNMENT SPENDING FLAT IN REAL TERMS IN THE COMING FISCAL YEAR AND TO REDUCE THE PROPORTION OF THOSE EXPENDITURES COVERED BY GRANTS FROM THE CENTRAL GOVERNMENT, ANTHONY CROSLAND, SECRETARY OF STATE FOR THE ENVIRONMENT HAS NOW ANNOUNCED A REDUCTION IN 1976/77 FUNDS FOR MORTGAGE LOANS AND RENOVATION AVAILABLE FOR PUBLIC HOUSING. DURING THE CURRENT FISCAL YEAR IT IS ESTIMATED THAT EXPENDITURES ON PUBLIC HOUSING WILL BE 900 MILLION POUNDS COMPARED WITH THE 830 MILLION ORIGINALLY BUDGETED. THE NEW FIGURE FOR THE 1976/77 FISCAL YEAR ANNOUNCED BY MR. CROSLAND IS 769 MILLION POUNDS OR OVER 15 PERCENT BELOW CURRENT LEVELS. IN MAKING THIS CUT, MR. CROSLAND NOTED THAT LOCAL AUTHORITY MORTGAGES PRESENTLY ACCOUNT FOR 17 PERCENT OF THE TOTAL MORTGAGE MARKET. THE CUT IN FUNDS WOULD REDUCE THIS FIGURE TOWARD THE MORE NORMAL LEVEL OF 6 PERCENT. HE POINTED OUT THAT SAVINGS AND LAMBA INSTITUTIONS WERE NOW FLUSH WITH FUNDS AND WOULD BE WELL PLACED TO TAKE UP SOME OF THE SLACK.

7. U.K. RESERVES. UK OFFICIAL RESERVES FELL BY \$177 MILLION DURING DECEMBER. THE DECLINE FOLLOWED ACCRUALS OF \$82 MILLION IN FOREIGN CURRENCY BORROWINGS BY THE

PUBLIC SECTOR UNDER THE EXCHANGE COVER SCHEME AND LONG.

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TERM DEBT SERVICING PAYMENTS OF \$220 MILLION (\$179 MILLION TO THE U.S. AND \$41 MILLION TO CANADA). AT THE END OF DECEMBER, RESERVES STOOD AT \$5,429 MILLION (AT CURRENT MARKET RATE OF EXCHANGE OF \$2.0233), COMPARED TO \$6,789 MILLION.

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LION AT THE END OF DECEMBER 1974.

8. UK CAR PRODUCTION. PASSENGER CAR PRODUCTION IN 1975 FELL 18 PERCENT IN 1975 TO A TOTAL OF 1.26 MILLION FROM THE 1974 LEVEL OF 1.53 MILLION. THIS WAS THE LOWEST LEVEL OF OUTPUT SINCE 1962. OUTPUT WAS AFFECTED BY SEVERE LABOR PROBLEMS AT BRITISH LEYLAND, CHRYSLER AND FORD TOGETHER WITH A GENERAL WEAKNESS IN DEMAND. IN THE FACE OF THESE DOMESTIC PROBLEMS, IMPORTS IMPROVED THEIR SHARE OF THE UK MARKET FROM 27.1 PERCENT IN 1974 TO 33.0 PERCENT IN 1975. UK CAR PRODUCTION BY 1976 SHOULD IMPROVE AS INDUSTRIAL RELATIONS BECOME SMOOTHER AND THE LEVEL OF DEMAND STRENGTHENS.

9. EXCHANGE RATE AND GOLD:

(DATES)	12/31	1/8	CHANGE
EXCHANGE RATE	\$2.0237	\$2.0345	UP \$0.0108
EFFECTIVE DEPRECIATION			
(PERCENT)	30.1	30.0	NARROWED 0.1
GOLD	\$140.50	\$136.00	DOWN \$4.50

10. FORWARD DISCOUNT ON STERLING:

(DATES)	12/31	1/8	CHANGE
1 MONTH	0.95	0.85	DOWN 0.10
3 MONTHS	2.55	2.42	DOWN 0.13
6 MONTHS	4.60	4.43	DOWN 0.17

(ALL FIGURES IN CENTS)

11. EURODOLLAR INTEREST RATES:

(DATES)	12/31	1/8	CHANGE
1 MONTH	5-1/2	5-3/4	UP 1/4
3 MONTHS	5.7/8	5.5/8	DOWN 1/4
6 MONTHS	63/4	6	DOWN 3/4

12. LOCAL AUTHORITY DEPOSIT RATES:

(DATES)	12/31	1/8	CHANGE
1 MONTH	10-13/16	10-7/16	DOWN 3/8
3 MONTHS	1015/16	10-1/2	DOWN 7/16
6 MONTHS	11-1/16	10.9/16	DOWN 1/2

13. THE MINIMUM LENDING RATE WAS REDUCED BY 1/4 PERCENT
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ON FRIDAY, JANUARY 2 TO 11 PERCENT. THE MINIMUM LENDING
RATE REMAINS AT 11 PERCENT AS OF FRIDAY, JANUARY 9, 1976.

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